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RUEHNH/AMCONSUL NAHA PRIORITY 1586
RUEHOK/AMCONSUL OSAKA KOBE PRIORITY 2950
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C O N F I D E N T I A L SECTION 01 OF 02 TOKYO 002134

SIPDIS

TREASURY FOR WINSHIP, DOHNER; USTR FOR WCUTLER AND MBEEMAN;
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SUBJECT: JAPAN APPROVES RESTRICTIVE BUDGET REQUEST
GUIDELINES FOR FY 2009

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Classified By: J. Thomas Schieffer for reasons 1.4 b, d.

11. (C) Summary. Prior to reshuffling, the Fukuda Cabinet completed the first major phase of the fiscal year 2009 budget process July 29 by setting restrictive guidelines for budget requests from individual ministries and agencies. Under the guidelines, ministerial budget spending is estimated to total 47.8 trillion yen (\$446.7 billion), up about 1.2 percent compared to the current fiscal year 2008 budget. Social security spending accounts for all of the increase. Ministerial budget spending has been essentially unchanged, around 47 trillion yen (\$439.2 billion) since fiscal year 2002, while social security spending has increased 4.3 trillion yen (\$40.2 billion), or 25.1 percent, due primarily to an aging population. The guidelines demonstrate the Fukuda government's commitment to the medium-term fiscal consolidation goals Prime Minister Koizumi set forth in 2006 and its intention to curb discretionary spending even as the ruling party politicians want to find ways to curry voter support as they look to a possible near-term Lower House election and Japan's economy softens. End summary.

Six Categories for Budget Requests

12. (SBU) In setting the budget request guidelines, the Ministry of Finance (MOF) divided ministerial budget spending into six categories. (Note: Budget request guidelines govern ministerial budget spending, the core component of the central government's general account budget, which accounts for nearly 60 percent of total general account expenditures. The guidelines do not cover two mandated spending items, debt service costs and revenue sharing with local governments, which account for the remaining 40 percent. Outlays under these two items are initially estimated at the end of August and finalized in December. The guidelines do not cover outlays under the Fiscal Investment and Loan Program (FILP). End note.) The following is a brief description of the Cabinet-approved budget request guidelines for each category:

13. SBU) Social Security: spending requests will be allowed to increase 650 billion yen (\$6.1 billion), or three percent from the present fiscal year 2008 budget, to 21.6 trillion yen (\$202 billion). This figure represents a 220 billion yen (\$2.1 billion) reduction from the initial social security

spending estimates in line with the medium term fiscal consolidation plan approved by the Koizumi Cabinet in 2006. Outlays under this category, including pension and medical care expenditures, account for 45.2 percent of total ministerial requests. At present, the fiscal year 2009 budget guidelines do not include the GOJ-agreed upon increase in the share of the central government's funding of the basic national pension scheme from the current one-third to the one-half scheduled for fiscal year 2009. The cost of the increased government pension contributions is estimated to be 2.3 trillion yen (\$21.5 billion); the issue is to be decided by late December 2008, before the Cabinet approves its 2009 fiscal year budget proposals. Many observers had expected the GOJ to fund this increase in contributions with a consumption tax hike.

¶4. (SBU) Public Works: spending requests under the general budget account will be reduced 300 billion yen (\$2.8 billion), or five percent, from the 2008 fiscal year level to 6.4 trillion yen (\$59.8 billion). The medium term plan requires an annual three percent cut in public works spending and the Fukuda Cabinet is calling for an additional two percentage point cut in spending to offset the spending in priority areas (see description below). As anticipated, the guidelines did not set a specific amount for road improvement spending requests. Outlays under this category account for 13.4 percent of total ministerial budget requests.

¶5. (SBU) Discretionary Non-Investment: spending requests will be cut approximately 300 billion yen (\$2.8 billion), or five percent, from fiscal year 2008 levels, to 7.1 trillion yen (\$66.4 billion), again two percentage points more than the previous year to accommodate spending for priority areas. Under this category, spending requests are either 1) reduced

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two percent from the fiscal year 2008 budget; 2) reduced three percent, or; 3) reduced five percent. For example, science and technology spending requests would be cut two percent from 2008 fiscal budget levels, while spending on most categories of national defense and official development assistance (ODA) will be reduced three and five percent, respectively. (Note: Spending for the realignment of U.S. forces in Japan is not subject to the three percent cut in defense budget requests, and is to be decided by late December in the budget compilation process. Host Nation Support provided under the 2008 Special Measures Agreement (SMA) is, however, subject to the spending cap. Since spending levels are already established under the bilateral SMA at the amount as last year, the Defense Ministry will be required to seek additional cuts elsewhere in the Defense Budget. Including realignment spending, the defense budget will be cut by one percent. End note.) Like public works spending requests, the cuts in discretionary non-investment budget requests are two percentage points greater than in JPY 2007 to free up funds for priority areas. Outlays under this discretionary non-investment category account for 14.8 percent of total ministerial budget requests.

¶6. (SBU) Priority Policy Areas: individual ministries and agencies are allowed to make additional spending requests of up to a combined 330 billion yen (\$3.1 billion) on the following Cabinet-designated priorities: 1) boosting economic growth potential; 2) revitalizing local regions; 3) building a low-carbon society; 4) securing social security programs; and 5) improving quality of people's livelihoods (including measures to raise the food self-sufficiency ratio). Outlays under this category account for 0.7 percent of total ministerial budget requests.

¶7. (SBU) Obligatory Non-Social Security/Non-Investment: spending requests, including subsidies to local governments, will increase 200 billion yen (\$1.8 billion), or nearly three percent, to 7.8 trillion yen (\$72.9 billion). This small rise reflects projected spending associated with the upcoming Lower House election. Excluding this factor, this category

will be almost unchanged from fiscal year 2008 levels. Outlays will account for 16.3 percent of total ministerial budget requests.

¶18. (SBU) Government Employee Wages: spending requests will increase 100 billion yen (\$934.6 million), or two percent, to 4.6 trillion yen (\$42.9 billion). Outlays under this category account for the remaining 9.6 percent.

Next Steps

¶19. (U) Individual ministries and agencies are now required to develop detailed budget requests for submission to MOF by the end of August. Inter-ministerial and political negotiations then follow. The Cabinet will approve a consolidated budget in late December before sending it to the Diet in January 2009.
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